Supreme Court, U.S.
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No. .....

In the Supreme Court of the United States

OCTOBER TERM, 1995

THE BANK OF CALIFORNIA, N.A.,)
TRUSTEE OF THE)
JULIA D. RAGSDALE TRUST)
UNDER INSTRUMENT)
DATED FEBRUARY 14, 1990,)
Petitioner,)
vs.)
OREGON DEPARTMENT OF REVENUE,)
Respondent.)

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF OREGON

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76 pp

QUESTION PRESENTED

Can a state defeat a constitutional mandate of this Court by enacting a sham statute that purports to tax state and federal government pensions equally but that, at the same time, rebates the state tax to state government retirees in the form of an increased pension, thus attempting to avoid the federal requirement of equality of taxation of state and federal retirees as pronounced by this court in *Reich v. Collins,* 513 U.S. ____, 130 L.Ed.2d 454, 115 S.Ct. _____, (1994); *Harper v. Virginia Department of Taxation,* 509 U.S. _____, 125 L.Ed.2d 74, 113 S.Ct. 2510 (1993); and *Davis v. Michigan Department of Treasury,* 489 U.S. 803, 103 L.Ed.2d 891, 109 S.Ct. 1500 (1989)?

LISTING OF PARTIES

The listing of the parties in the court the judgment of which is sought to be reviewed (Supreme Court of the State of Oregon) are as follows:

(i) Julia D. Ragsdale, an individual, of Portland, Oregon, plaintiff-appellant below, and petitioner here;

(ii) Oregon Department of Revenue, defendant-respondent below, and respondent here.

Mrs. Ragsdale died on February 18, 1995, while this case was pending before the Oregon Supreme Court. Mrs. Ragsdale's successor trustee, The Bank of California, N.A., is the named petitioner in this proceeding.

The Bank of California, N.A., is a wholly owned subsidiary of Mitsubishi Bank, Ltd., a Japanese corporation.

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CITATION TO CASE OPINIONS IN THIS PROCEEDING

1. *Oregon Tax Court: Ragsdale v. Department of Revenue,* tax court docket number 3535, opinion published at 13 Oregon Tax Reporter 143 (1994), and reproduced in the appendix to this petition.

2. *Oregon Supreme Court: Ragsdale v. Department of Revenue,* supreme court docket number S-41581, opinion published at 321 Or. 216, 895 P.2d 1348 (1995), and reproduced in the appendix to this petition.

STATEMENT OF SUPREME COURT JURISDICTION

The judgment of the Oregon Supreme Court in this case was entered on July 11, 1995. Appendix, p. A-35.

The provisions of 28 USC 1257 (1988) allow review of a judgment of the highest court of a state where the validity of a state statute is drawn into question on the ground that the state statute is contrary to the federal statutes or federal constitution, both grounds being involved here.

The question presented in the courts below, as in this Court, is whether chapters 796 and 823 of the 1991 Oregon Laws violate 4 USC 111 (state taxation of federally paid compensation must not discriminate against federal employees) and section 2 of article VI of the federal constitution (supremacy clause).

STATUTORY PROVISIONS

4 USC 111

The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States, a territory or possession or political subdivision thereof, the government of the District of Columbia, or an agency or instrumentality of one or more of the foregoing, by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

1991 OREGON LAWS, CHAPTERS 796 AND 823

These items are lengthy and are set out in pertinent part in the appendix to this petition.

STATEMENT OF THE CASE

This is a tax refund case that began with a claim for refund for the calendar year 1991 filed by Mrs. Ragsdale with the Oregon Department of Revenue. It is stipulated that all filings were timely and all administrative procedures were properly used.

The issue of the invalidity of the state statutes in the face of 4 USC 111 was raised by Mrs. Ragsdale in her 1991 claim for refund, and the issue was ruled on by the Oregon Department of Revenue, the Oregon Tax Court (13 OTR 143 (1994)), and the Oregon Supreme Court (321 Or. 216, 895 P.2d 1348 (1995)). The department of revenue, the Oregon Tax Court, and the Oregon Supreme Court all upheld the validity of the Oregon statutes.

It is stipulated that Mrs. Ragsdale (and, now, with her death, her trust estate) is entitled to a 1991 Oregon income tax refund of $1,092.44 if the Oregon statutes are invalid, as alleged.

There is a direct and clear conflict between the decision of the Supreme Court of Montana in *Sheehy v. Public Employees Retirement Division,* 262 Mont. 129, 864 P.2d 762 (1993) and the decision of the Supreme Court of Oregon in this case, *Ragsdale v. Department of Revenue,* 321 Or. 216, 895 P.2d 1348 (1995).

The Montana Supreme Court in *Sheehy* held that a Montana statute granting an increased pension to offset the state income tax imposed on state retirees *was* an unconstitutional discrimination against federal retirees who did not get such a benefit from the state. The Oregon Supreme Court in this case held that the Oregon statute granting an increased pension to offset the state income tax imposed on state retirees was *not* an unconstitutional discrimination against federal retirees who did not get such a benefit from the state.

ARGUMENT

After this Court's decision in *Davis v. Michigan Department of Treasury,* Julia Ragsdale filed claims for refund raising the issue of whether her federal pensions were taxed illegally by Oregon based on the *Davis* case. In *Ragsdale v. Department of Revenue,* 312 Or. 529, 823 P.2d 971 (1992) (referred to as Ragsdale I) the Oregon Supreme Court held that Oregon's income tax was unconstitutional under *Davis.*

In order to get around that decision of the Oregon Supreme Court, the legislature enacted the Oregon statute here in question, the effect of which was to tax state and federal retirees equally, but then to rebate the state employees' tax through the device of a special pension increase.

The question presented is whether a state may lawfully defeat a constitutional mandate of the Supreme Court of the United States by enacting a sham statute that purports to tax state and federal government pensions equally, but that, at the same time, rebates the state tax to state government retirees in the form of an increased pension, thus attempting to avoid the federal requirement of equality of taxation of state and federal retirees in 4 USC 111 and as pronounced by this Court in *Reich v. Collins,* 513 U.S. ___, 130 L.Ed.2d 454, 115 S.Ct. __ (1994); *Harper v. Virginia Department of Taxation,* 509 U.S. ___, 125 L.Ed.2d 74, 113 S.Ct. 2510 (1993); and *Davis v. Michigan Department of Treasury,* 489 U.S. 803, 103 L.Ed.2d 891, 109 S.Ct. 1500 (1989).

This same scheme of evasion has been tried in at least two states, Montana and Oregon. In Montana, the scheme was struck down and tax refunds were ordered for federal retirees

who were discriminatorily taxed by the state. *Sheehy v. Public Employees Retirement Division,* 262 Mont. 129, 864 P.2d 762 (1993).

But in Oregon, the state supreme court in this case held that the scheme did not offend the federal statute or federal constitution and the refund was denied. *Ragsdale v. Department of Revenue,* 321 Or. 216, 895 P.2d 1348 (1995).

Thus, there is a direct and clear conflict between the decision of the Supreme Court of Montana in *Sheehy* and the decision of the Supreme Court of Oregon in *Ragsdale.*

The record in this case clearly presents the issue.

First, the stipulated facts and exhibits show that the authoritative legislative history of the Oregon scheme discloses without question that "the purpose of the [state employees' pension] benefit increase is to help offset the tax impact created by HB 2352, which subjects ... [state] pensions to state income taxation." Joint Exhibit 1-A, p.55. The legislative summary presented to the Oregon House Committee on Labor reads (*Id.*, p. 57):

> "WHAT THE BILL DOES: Provides a scheduled increase in the monthly retirement benefits for members and retirees of PERS, the Judges' Retirement System and nonPERS police and fire retirement systems to offset any burden created by the legislature's decision to equalize tax treatment of state and federal retirees. The measure provides currently retired members and retired persons whose effective date of retirement or death is on or after January 1, 1991 with an increase based upon years of service."

Thus, there can be no doubt on this record of the intent, purpose, and actual effect of the Oregon law.

Second, the precise issue of invalidity of the statute was raised in Mrs. Ragsdale's original 1991 claim for refund and was considered and flatly rejected by the Oregon Department of Revenue, the Oregon Tax Court, and the Oregon Supreme Court. Thus, both the record and the legal contentions of the parties have been fully developed.

Because the question presented involves millions of dollars in tax refunds to federal retirees in Oregon, and because the scheme of state taxation attempted here is a clear evasion of this Court's mandates in *Reich*, *Harper*, and *Davis*, we ask the Court to grant the petition and to hear our case.

There is ample authority for this Court's looking through clever legislative labels to find the economic substance and practical effect of a statute. *U.S. Term Limits, Inc. v. Thornton*, 514 U.S._, 131 L.Ed.2d 881, 115 S.Ct. ___ (1995) (Arkansas statute labeled as a manner of regulating elections was really, in substance, an additional qualification for federal office); *Montana Department of Revenue v. Kurth Ranch*, 511 U.S._, 128 L.Ed.2d 767, 114 S.Ct._(1994) (Montana statute labeled as a tax assessed on persons convicted under state drug laws was really, in substance, a penalty for dealing in drugs); *Edwards v. Aguillard*, 482 U.S. 578, 96 L.Ed.2d 510, 107 S.Ct. 2573 (1987) (Louisiana statute labeled as an academic freedom provision was really, in substance, an unlawful establishment of religion).

Accordingly, following the authorities in the preceding paragraph, petitioner asks the Court not to be misled by the device used by the Oregon Legislature to achieve its discriminatory goal. Instead of a candid tax rebate, the legislators chose to disguise the tax rebate as an increased pension pay-

ment. This is a mere label and does not, or should not, obscure the true nature of the payment. It is uncontested that the purpose of the 1991 legislation was to provide state pensioners with a partial refund of Oregon income tax paid on their pensions. Given that, the Court's decision should not be grounded on the label used by the state to disguise the tax refund. Under federal constitutional law, a sham statement of legislative purpose will not shield an unconstitutional state enactment from being struck down. This principle was explicitly stated by the Montana Supreme Court in *Sheehy:*

> "We conclude that the [pension] adjustment is a partial tax rebate denominated otherwise in an attempt to evade the requirements of federal law. The discriminatory aspects of the adjustment is clear: the adjustment favors state retirees living in Montana based solely on the source of their retirement income; that is, those retirees living in Montana and receiving state retirement income receive the adjustment, while federal retirees living in Montana and receiving federal retirement income do not. Thus, the adjustment constitutes discriminatory taxation based solely on the source of the respective retiree's income, in violation of 4 USC § 111." *Sheehy v. Public Employees Retirement Division,* 262 Mont. 129, __, 864 P.2d 762, 768-69 (1993).

Oregon Justice Michael Gillette and Oregon Justice Edward Fadeley, dissenting in the case below, said essentially the same thing:

> "The majority today approves a legislative device specifically and narrowly tailored to avoid the rule of intergovernmental tax

immunity that was explicated by the Supreme Court of the United States.... Because I believe that the legislative scheme does not avoid discriminating between state and federal retirees pensions benefits, based on the source of those benefits, I dissent.

* * *

"But it is argued here—and the majority buys the argument—that the legislature's increase in PERS benefits, while motivated by the requirement that state retirees now pay taxes on their state retirement benefits, is nonetheless simply 'increased compensation' and, as such, unrelated to any taxes that any federal retiree may be paying. With respect, I disagree. In spite of the difference in label—'refund' vs. 'increased compensation'—I can find no difference in substance here. The pertinent focus here is the degree to which that 'increased compensation' is tied to—indeed, is completely contingent on—an obligation on the part of state retirees to pay state income taxes on their PERS retirement benefits. When the state says to state retirees, 'We will increase your retirement benefits, but only because you now are being taxed on them and only for as long as you continue to be taxed on them,' the state is talking about a tax refund. And, because the state retirees are receiving a refund of taxes paid on their state retirement income to which federal retirees are not, on the same terms, entitled with respect to their federal retirement income, the violation of the doc-

> trine of intergovernmental tax immunity, as explained in *Davis*, is patent. Substance counts; labels do not."
> *Ragsdale v. Department of Revenue*, 321 Or. 216, 233, 234, 895 P.2d 1348 (1995) (Gillette, J. dissenting).

Based on the conflict in state supreme court decisions, and on the large amount of tax refunds at issue for federal retirees in Oregon, and on the apparent attempt here by the State of Oregon to evade the mandate of this Court, we ask that our petition for writ of certiorari to the Supreme Court of the State of Oregon be granted and that this matter be heard on its merits.

* * *

Respectfully submitted,

OCT 10 1995

Date

/S/ JOSEPH WETZEL

Joseph Wetzel
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APPENDIX

(Supreme Court Rule 14.1(i))

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2. Copy of Oregon Tax Court opinion in *Ragsdale v. Department of Revenue*, No. 3535 (1994) A-30

3. Copy of Oregon Supreme Court appellate judgment dated July 11, 1995 ..... A-35

4. Copy of Chapter 796, 1991 Oregon Laws A-37

5. Copy of sections 1 and 5 of Chapter 823, 1991 Oregon Laws A-53

APPENDIX 1

IN THE SUPREME COURT OF THE
STATE OF OREGON

Julia D. RAGSDALE,
Appellant,

v.

DEPARTMENT OF REVENUE,
STATE OF OREGON,
Respondent.
(OTC 3535; SC S41581)

In Banc On appeal from the Oregon Tax Court.* Carl N. Byers, Judge. Argued and submitted March 9, 1995.

Gary R. DeFrang, of Wetzel DeFrang & Sandor, Portland, argued the cause for appellant. With him on the brief were Joseph Wetzel and Russell A. Sandor.

Marilyn J. Harbur, Assistant Attorney General, Salem, argued the cause for respondent. With her on the response was Theodore R. Kulongoski, Attorney General, Salem.

VAN HOOMISSEN, J.

The judgment of the Tax Court is affirmed.

Gillette, J., dissented and filed an opinion, in which Fadeley, J., joined.

Fadeley, J., dissented and filed an opinion.

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*13 OTR 143 (1994).

VAN HOOMISSEN, J.

In this direct appeal from the Oregon Tax Court, ORS 305.445, taxpayer challenges a judgment that denied her claim for a refund of state income taxes paid on her federal retirement benefits for the tax year 1991. *Ragsdale V. Dept. of Rev.,* 13 OTR 143 (1994). She claims that Oregon discriminates in taxation between state and federal retirees in violation of the federal constitutional and statutory doctrine of intergovernmental tax immunity.[1] This court reviews *de novo*. ORS 305.445; 19.125(3). For the reasons that follow, we affirm the judgment of the Tax Court.

At all times relevant to this appeal, retired public employees of the State of Oregon and of its political subdivisions and instrumentalities have received retirement benefits attributable to their employment under the Public Employes' Retirement System (PERS).[2] *See* ORS chapter 237 (Public Employes' Retirement). Before 1991, ORS 237.201(1989)

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[1] 4 USC § 111 provides in part:

"The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States * * * by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation."

Intergovernmental tax immunity is based on the need to protect each sovereign's governmental operations from undue interference by the other. *Davis v. Michigan Dept. of Treasury,* 489 US 803, 814, 109 S Ct 1500, 103 LEd 2d 891 (1989). 4 USC § 111 "waives whatever immunity past and present federal employees would otherwise enjoy from state taxation of salaries, retirement benefits, and other forms of compensation paid on account of their employment with the federal government, except to the extent that such taxation discriminates on account of the source of compensation." *Davis,* 489 US at 810.

[2] Members of the Oregon Public Employes' Retirement System (PERS) include employees of the State of Oregon and of its political subdivisions and instrumentalities. Throughout this opinion, they will be referred to as "state retirees" and their present or future benefits as "PERS retirement benefits."

provided that PERS retirement benefits were exempt from all state taxes.[3] Further, ORS 316.680(1)(d) (1989) excluded PERS retirement benefits from the taxable income base on which state income taxes were computed. There was no comparable statutory provision exempting federal retirement benefits from state taxes. As a result, Oregon taxed federal retirement benefits, but not PERS retirement benefits.[4]

In 1989, the Supreme Court of the United States decided *Davis V. Michigan Dept. of Treasury,* 489 US 803, 817, 109 S Ct 1500, 103 L Ed 2d 891 (1989). At issue in *Davis* was whether a Michigan statute that fully taxed all federal retirement benefits, but excluded from taxable income all retirement benefits received from the State of Michigan or its political subdivisions, violated the principle of intergovernmental tax immunity by favoring retired state and local government employees over retired federal employees based on the source of the benefits.[5]

In *Davis*, the Supreme Court held that, if a state exempts retirement benefits paid by state and local governments from state income taxes without similarly exempting retirement benefits paid by the federal government from state income taxes, then that state violates the principle of intergovernmental tax immunity. *Davis,* 489 US at 810-17. That is to say, a

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[3] For a more detailed explanation of the statutory basis for the tax exemption of PERS retirement benefits, see *Hughes v. State of Oregon,* 314 Or 1, 6-10, 838 P2d 1018 (1992).

[4] Federal civil service retirement benefits are deferred compensation for past years of service rendered to the federal government. *Davis,* 489 US at 808. Likewise, PERS retirement benefits are deferred compensation. *Hughes,* 314 Or at 25 n 30.

[5] At the time the Supreme Court decided *Davis,* 23 states gave preferential tax treatment to benefits received by employees of state and local governments relative to the tax treatment of benefits received by federal employees. *Harper v. Virginia Dept. of Taxation,* 509 US____, 113 S Ct 2510, 125 LEd 2d 74 (1993).

state may not discriminate in taxation between state and federal retirement benefits, based on the source of the benefits.[6] The Supreme Court stated: "It is undisputed that Michigan's tax system discriminates in favor of retired state employees and against retired federal employees." *Id.* at 814. Moreover, Michigan's inconsistent tax treatment of retired state employees and retired federal employees was not justified by "significant differences between the two classes" of employees. *Id.* at 817. The Court concluded that, by favoring retired state and local government employees over retired federal employees, the Michigan statute violated the principle of intergovernmental tax immunity. *Id.*[7]

The appropriate remedy, the Court announced, is a mandate of "equal treatment, a result that can be accomplished by withdrawal of benefits from the favored class as well as by extension of benefits to the excluded class." *Id.* at 817-18.

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[6] The holding in *Davis* is to be applied retroactively. *Harper,* 509 US at __, 113 S Ct at 2513. It also protects military retirees from discriminatory state taxation.

Barker v Kansas, 503 US ____, 112 S Ct 1619, 118 L Ed 2d 243 (1992).

[7] Under *Davis,* a state tax that is alleged to discriminate against federal retirees is evaluated by inquiring "whether the inconsistent tax treatment is directly related to, or justified by, 'significant differences between the two classes ' "489 US at 816. The Court held that any difference in tax treatment between federal and state employees must be justified by significant differences between the two groups. According to the Court, Michigan's justification for its statutory exemption—its interest in hiring and retaining qualified civil servants—was irrelevant to any inquiry into the difference between the two classes, no matter how substantial such an interest might be. 489 US at 816.

In response to Michigan's argument that the exemption was designed to compensate for comparatively lesser benefits afforded by state retirement benefits as compared to federal benefits, the Supreme Court stated that, although this was probably true when comparing the average state employee to the average federal employee, it was certainly not true in a number of instances. Furthermore. the Court concluded, if the difference in pay were truly the state's motivation, it would have adopted a statute based on the amount of retirement benefits received not on the source of the benefits. 489 US at 816-17.

> "[A]ppellant's claim could be resolved either by extending the tax exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees. * * * [T]he Michigan courts are in the best position to determine how to comply with the mandate of equal treatment." *Id.* at 818.

This court later applied *Davis* and held that Oregon's taxation scheme, which was similar to the Michigan taxation scheme challenged in *Davis,* "impermissibly discriminated against employees of the federal government in violation of the constitutional doctrine of intergovernmental tax immunity." *Ragsdale v. Dept. of Rev.,* 312 Or 529, 542, 823 P2d 971 (1992).[8]

In response to *Davis,* the 1991 Oregon legislature amended ORS 237.201 (1989) by repealing the tax exemption previously granted to PERS retirement benefits. Or Laws 1991, ch 823, § 1. The 1991 legislature also repealed ORS 316.680(1)(d) (1989), which excluded PERS retirement benefits from the state taxable income base. Or Laws 1991, ch 823, § 3. Following those statutory amendments, federal and PERS retirement benefits have been taxed alike under state income tax statutes.

The 1991 legislature also increased PERS retirement benefits payable to some state retirees. Or Laws 1991, ch 796. The increased PERS retirement benefits are based on an

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[8] *Ragsdale* involved this same taxpayer's Oregon income tax liabilities for the years 1970 through 1988. This court ordered the department to issue a tax refund to taxpayer for the year 1988 and a refund of any excess tax paid by her for "any tax years thereafter, if any, in which federal retirement income was included in her state taxable income at a time when, for the same tax year, state retirement income was completely exempt from state taxation." *Id.* at 542.

employee's years of service and range from one percent (10 to 20 years of service) to four percent (30 or more years of service). *Id.* at § 6. The benefits are not calculated on actual or even potential tax liability. That is to say, there is no mathematical correlation between taxes and the benefits created in 1991. Some state retirees who will be required to pay state income taxes on their PERS retirement benefits will receive no additional benefits under the 1991 law. Conversely, some state retirees who will pay no state income taxes will receive additional benefits. The benefits received pursuant to the 1991 statute are themselves subject to state and federal income taxation. The 1991 increase in PERS retirement benefits is funded by the PERS retirement trust fund. *See* ORS 237.271 (the Public Employes' Retirement Fund is a trust fund separate and distinct from the General Fund. Public employers that make contributions to the fund have no proprietary interest in the fund or in their contributions to the fund.).

Oregon Laws 1991, chapter 796, also provides that those increased PERS retirement benefits "shall not be paid in any tax year in which the retirement benefits payable under the Public Employes' Retirement System are exempt from Oregon personal income taxation." *Id.* at § 12. Oregon Laws 1991, chapter 796, section 12, further provides:

> "In the event increased benefits under chapter 796, Oregon Laws 1991, are paid in a tax year in which the retirement benefits payable under the system are exempt from Oregon personal income taxation, the benefits shall not be recoverable by the system, but the Public Employes' Retirement Board shall insure that no additional amounts are paid under the provisions of chapter 796, Oregon Laws 1991."

Although the 1991 legislature chose to increase PERS retirement benefits payable to some state retirees, it did not extend any reciprocal benefits to federal retirees taxed under Oregon Laws 1991, chapter 823.

Current and retired state employees affected by the 1991 legislative changes that subjected PERS retirement benefits to state income taxation sued the state for breach of their employment contracts. In *Hughes v. State of Oregon,* 314 Or 1, 33, 838 P2d 1018 (1992), this court held that, by subjecting PERS retirement benefits to state income taxation, the state had breached certain contracts between the state and its current and retired employees:

> "[B]y repealing the tax exemption previously afforded by *former* ORS 316.680(1)(d) (1989), section 3 of the 1991 law results in the taxation of PERS retirement benefits, an action in breach of the tax exemption term of the PERS contract. In other words, the state has chosen, pursuant to section 3 of the 1991 law, to breach the tax exemption term of the PERS contract that the state has with its employees. This the state may not do with impunity. Anyone whose PERS benefits are contractually exempt from taxation, in whole or in part, is entitled to a remedy for the state's breach."

This court declined to fashion a remedy for that breach of contract, leaving it to the legislature, in the first instance, to choose among the avallable remedies. *Id.* at 33 n 36.[9] Federal

[9] The legislature has yet to act in response to this court's holding in Hughes. New litigation currently is pending. See, e.g., *Chess v. State of Oregon,* 93C-11180 and *Stovall v. State of Oregon,* 94C-10334 (consolidated cases), Circuit Court, Marion County (1995).

retirees, of course, were not parties to the *Hughes* litigation and, thus, they were not direct beneficiaries of its holding.

Taxpayer is a federal retiree and a resident of Oregon. During 1991, she received federal retirement benefits totaling $31,184, as compensation for services that she had rendered as an employee of the United States. The state tax liability attributable to that income was $2,865.06, which she paid in a timely manner. In 1992, taxpayer filed an amended individual income tax return requesting a refund of the $2,865.06, plus interest, arguing that Oregon impermissibly discriminated in the taxation of federal retirement benefits as compared to the taxation of PERS retirement benefits. The Department of Revenue (department) denied the refund.

Taxpayer appealed to the Oregon Tax Court, which sustained the department's order, explaining:

> "[Taxpayer's] argument is based on an economic analysis which assumes the state may not do with the left hand what it cannot do with the right. An appropriate response to [taxpayer's] argument echoes the language of *Davis:* What the state does with regard to compensation of its employees, current or retired, is simply irrelevant to an inquiry as to the tax treatment of state and federal pensions.
>
> "In essence, [taxpayer] argues that the state cannot change the compensation of its employees without forfeiting the right to tax federal pension income. This is the very type of interference that the doctrine of intergovernmental tax immunity was intended to prevent. *Davis* did not mandate that state and federal retirees must receive equal pension benefits.

> Rather, *Davis* requires that both classes must be treated equally by the state's income tax laws. That the state may relieve its employees of the economic consequences of *Davis* merely demonstrates that the Supreme Court threw its net into a shallow pond. The only economic effect noted by the court in *Davis* was an increase in federal income taxes 'in some circumstances.' *Davis* at 816, n 4. Aside from administrative confusion and the initial costs of refunds and adjusting systems, *Davis* need have little economic consequence in Oregon.
>
> "In summary, [taxpayer] has not shown or asserted any discrimination in the tax treatment of state and federal retirees. *Davis* does not hold or even intimate that a state is prohibited from adjusting the compensation of its employees, either currently or retired, to make up for the loss of the exemption." *Ragsdale,* 13 OTR at 145-46.

Taxpayer then appealed to this court. ORS 305.445.

Taxpayer contends that the Tax Court erred in denying her claim for a refund of her personal income tax in the amount of $2,865.06, plus interest. She does not argue that any discrimination exists in the Oregon tax statutes *per se,* and she concedes that both federal and state retirement benefits are now taxed in like manner under the state income tax statutes. Rather, taxpayer argues that the imposition of an income tax on PERS retirement benefits by Oregon Laws 1991, chapter 823, section 3, was accompanied by a "tax rebate" to state retirees for the tax imposed, which federal retirees did not receive. Taxpayer further argues that state retirees are entitled to a remedy for the state's breach of contract under Hughes,

314 Or at 33, when federal retirees do not have an equivalent advantage with regard to their federal retirement benefits. Thus, taxpayer asserts, because state retirees may receive, now or later, increased PERS retirement benefits under Oregon Laws 1991, chapter 796, and contract damages under *Hughes*, the state discriminates against federal retirees who receive no comparable amounts. The disparate tax treatment between the recipients of PERS retirement benefits and federal retirement benefits, taxpayer asserts, violates the principle of intergovernmental tax immunity. Therefore, taxpayer maintains, she is entitled to a refund of the discriminatory tax she paid for the 1991 tax year, plus interest.

The department does not dispute that the 1991 legislature increased PERS retirement benefits to compensate state retirees, in part, for their increased income tax obligations resulting from the enactment of Oregon Laws 1991, chapter 823. However, the department does not agree with taxpayer's argument that the legislature's decision to make those increased payments was an exercise of the state's taxing authority. The department argues that the state was acting consistently with its contracting authority in anticipating the need to make a contract benefit level adjustment, either as "damages" or otherwise, in contrast to its taxing authority.[10]

The department argues that, because Oregon taxes PERS retirement benefits and federal retirement benefits equally,

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[10] The department argues:

> "[T]he legislature enacted [Oregon Laws 1991, chapter 796] prior to the decision of the Oregon Supreme Court in *Hughes*. Nevertheless, the legislature acted in anticipation of this court's decision in *Hughes*. The legislature is deemed to have been aware of the existing law, and could have reasonably anticipated the need to 'mitigate damages' by adjusting benefit levels as it did in [Oregon Laws 1991, chapter 796]."

In 1991, the legislature could not necessarily predict that in 1992 this court would hold in *Hughes* that the removal of the tax exemption was a breach of contract with a right of damages as a remedy. Indeed, in *Hughes*, the department argued against that result.

and because taxpayer incorrectly equates an increase in PERS retirement benefits with a tax refund, her claim of discrimination lacks merit. The department asserts that taxpayer has failed to recognize the distinction between a state adjustment of retirement benefit levels pursuant to contract and state action under its *taxing* authority.[11] The department further argues that payment of increased PERS retirement benefits to state retirees is compensation for services performed by the employees and that the payment of such benefits should not be characterized mistakenly as "imposition of a tax" or "a tax rebate" because, under *Hughes,* state retirees are lawfully entitled to an agreed upon level of retirement compensation, regardless of the form in which it may be paid.

The Supreme Court of the United States in *Davis* construed 4 USC § 111 to mandate "equal treatment" of recipients of state and federal retirement benefits. *Davis,* 489 US at 817-18. Accordingly, and subject to a showing that any inconsistent tax treatment is directly related to, and justified by, significant differences between the classes, a state may not discriminate *in taxation* between state and federal retirees, based on the source of the benefits. *Id.* at 817. The validity of taxpayer's argument hinges on the accuracy of her assumptions that the increased PERS retirement benefits of some state retirees under Oregon Laws 1991, chapter 796, and that the award of a remedy to PERS retirees pursuant to *Hughes* are, in effect, tax rebates to state retirees, which create discrimination

[11] We agree with the Tax Court that Davis does not hold or even intimate that a state is prohibited from adjusting the compensation of its employees, either currently or retired. *Ragsdale,* 13 OTR at 146. For example, if a comparable retirement benefit adjustment were provided in different legislation in further years, and denominated a "cost-of-living" adjustment, no one could argue seriously that that legislation discriminated in taxation against federal retirees. What is prohibited by *Davis* is taxation discrimination "'on account of the source of the compensation"that is not "directly related to, and justified by, 'significant differences between the two classes.' "489 US at 810, 816.

in taxation between state and federal retirees based on the source of the benefits. Intergovernmental tax immunity, which is the legal predicate for taxpayer's challenge, is concerned with discriminatory tax treatment. Therein lies the imperative that taxpayer be able to show that the benefits received under Oregon Laws 1991, chapter 796, are, or that any remedy under *Hughes* is, in effect, a tax rebate or tax benefit provided by the state only to state retirees in a manner that discriminates against federal retirees, based on the source of the benefits.

Intergovernmental tax immunity does not require that the state treat state and federal employees the same way, it requires only that the state system of taxation be equal. The statute and the doctrine provide that the United States consents to state taxation of its employees "if the taxation does not discriminate" against them because of the source of compensation.

It is important, first, to eliminate *Hughes* from further discussion. As noted, the 1991 statutory amendments were not, by definition, a legislative reaction to *Hughes,* much less a partial legislative award of damages for the breach of contract identified by that decision. *Hughes* was not decided until 1992, and the application—if any—of the doctrine of intergovernmental tax immunity to final resolution of damage actions brought in the wake of *Hughes* must await another day.[12] Taxpayer's sole viable argument in *this* case concerns the 1991 legislatively directed adjustment in PERS benefits.

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[12] State retirees are currently litigating the nature and extent of the state's and other PERS' participating employers' responsibility for damages under the PERS contract as a result of the *Hughes* case. Those cases are currently pending in the Marion County Circuit Court. *See* note 9, *ante.* Classes of plaintiffs and defendants have been certified. The measure of those damages is to be determined by the terms of the contract, as construed by the courts. But until the courts enter a decision as to those damages, taxpayer's claim that state retirees are being treated differently from federal retirees based on any damages that state retirees may be awarded in the future is premature. At this time there is no basis upon which to grant taxpayer's claim for a refund.

With respect to Oregon Laws 1991, chapter 796, that statute contains indicia that could lead one to conclude either that the "benefits" are a kind of tax rebate or that the "benefits" are compensation. The provision to end the payments if state taxation ends points toward a tax rebate. However, for the reasons that follow, we conclude that, in context, the 1991 legislation is a not tax rebate or tax benefit that would implicate the principle of intergovernmental tax immunity. Nothing in the present Oregon system discriminates in taxation against federal retirees on account of the *source* of compensation.

First, reference to the text of the *Davis* decision itself yields no indication that the federal doctrine of intergovernmental tax immunity concerns itself with the level of *compensation* that a state contracts to pay or pays its state retirees. 4 USC § 111, which codifies the doctrine of intergovernmental tax immunity, provides that the United States consents to the taxation of the compensation for services performed as a federal employee (including deferred compensation in the form of a federal pension), so long as the tax does not discriminate because of the federal source of that compensation. As with the Davis decision, nothing in 4 USC § 111 purports to control or concern itself with the level of *compensation* that the state pays its employees and retirees.

Second, not only is there nothing express in *Davis* or in 4 USC § 111 that would regulate the level of compensation of state employees, it would be illogical to suggest that there is anything in the underlying principle of intergovernmental tax immunity that would invalidate a state compensation plan in aspects unrelated to the level of taxation. The doctrine of intergovernmental tax immunity recognizes that separate state compensation responsibility to its officers and employees and requires only that the state treat service to the federal government in the same way that it treats service to the state govern-

ment when taxing the compensation for that service. Since 1991, Oregon has done just that. As noted, taxpayer concedes that both federal and state retirement benefits are taxed in like manner under the state income tax statutes.

Third, in *Davis,* the Supreme Court stated possible remedies for the intergovernmental tax immunity problem that it found in that case. The Supreme Court pointed to state cures "by extending the tax exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees." 489 US at 818. In direct response to *Davis,* the 1991 Oregon legislature amended ORS 237.201 to remove the tax exemption for PERS retirement benefits. That legislative act conformed Oregon law to the express dictates of *Davis,* by acting in a manner expressly approved by *Davis.*

Fourth, consistent with the points made above regarding state payment of *compensation* to its retirees, the increase in benefits provided by the 1991 legislature is not part of the system of state *taxation* in Oregon. It does not involve the assessment or collection of revenues, which is the hallmark of a tax. See *Automobile Club v. State of Oregon,* 314 Or 479, 485, 840 P2d 674 (1992) ("In the most general sense, a tax is 'any contribution imposed by government upon individuals, for the use and service of the state * * *' "). It involves the *expenditure* of trust funds, not the collection of state revenues.

The 1991 increase in compensation is not transformed into a tax rebate or tax benefit simply because it was motivated in whole or in part as a response to the *Davis* decision and the consequent removal of the tax exemption for PERS retirement benefits. Moreover, it is important to remember that state retirees will pay state and federal income taxes on any increased benefits they receive.

Fifth and last, we find no correlation, either direct or indirect, between state retirees' state tax obligations and the amount of increased PERS retirement benefits, if any, to which they may be entitled under the provisions of Oregon Laws 1991, chapter 796. As noted, the amounts of increased retirement benefits are based on the PERS members' years of service, *not* on their state income tax obligations. All eligible PERS retirees receive those increased benefits. Moreover, the increased benefits received pursuant to the 1991 statute are themselves subject to state and federal taxation. Indeed, taxpayer's claim for a tax refund measured by the increased benefit paid to state retirees incorrectly assumes that every state retiree who receives an increase in benefits paid state income taxes, but it is conceivable that many state retirees paid little or no state income tax for 1991. See, *e.g.*, ORS 316.157 (credit for retirement income).[13]

In sum, taxpayer's argument lacks both a factual and a legal predicate. The system of state taxation is not implicated by the 1991 increase in retirement benefits to some state retirees and the principle of intergovernmental tax immunity does not apply, because there is no discrimination in taxation on account of the source of compensation.

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[13] The department argues that taxpayer's claim for an amount of money equivalent to what was paid under Oregon Laws 1991, chapter 796, is speculative, because the amount of the payment bears no relationship to the actual state income tax paid by an individual PERS retiree for 1991 or any other year and, therefore, does not provide a good measure of "damages" for taxpayer. According to the department, credits or deductions for which a particular individual qualified in the 1991 tax year, or any other year, make generalizations about payment of income tax impossible. For example, ORS 316.157 (credit for retirement income) provided in 1991, and still does, for a credit in the amount of nine percent of net pension income to be taken against income tax by federal and state retirees. Application of that credit may reduce the state retirees' income tax related to PERS retirement benefits to zero. Because state retirees' income tax returns are not a part of the record in this case, the department cannot determine the extent to which that credit may have reduced tax payments for either federal or state retirees.

Taxpayer relies on *Sheehy v. Public Employees Retirement Div.*, 262 Mont 129, 864 P2d 762, *reh den* (1993). In *Sheehy*, retirees challenged certain provisions of Montana law enacted in response to *Davis*. Before *Davis*, Montana, like Oregon, taxed federal retirement benefits but exempted state retirement benefits. *Sheehy*, 262 Mont at 132, 864 P2d at 764.

The Montana Supreme Court described the 1991 Montana legislature's response to *Davis* as follows:

> "The Montana legislature subsequently passed Chapter 823, 1991 Montana Laws, which, according to its title, restructures the income tax on pension benefits by equalizing the taxation of all pension benefits. In lieu of extending the total exemption from taxation previously available to state retirement income to federal retirement income, the legislature opted in Chapter 823 to bring all retirement income—including both state and federal pensions—within the Montana income tax. * * *. In addition, section 5 of Chapter 823 grants to state retirees who are Montana residents, and who now were to be taxed in response to *Davis*, an annual retirement adjustment payment." *Sheehy*, 262 Mont at 132-33, 864 P2d at 764.

The Montana court concluded that the provisions of Montana Laws 1991, chapter 823, section 5, constituted discriminatory taxation in violation of the intergovernmental tax immunity provisions of 4 USC § 111, explaining:

> "It is clear that the adjustment is not an actual and legitimate pension or retirement benefit. If it were a pension benefit, the State

would have provided it to *all* of its retirees in recognition of their years of public service rather than just those living in Montana. There was no need to do so because the sole purpose of the adjustment was to partially recompense state retirees living in Montana for the tax they now must pay under the equalizing provisions of Chapter 823.

"Further evidence that the adjustment is not an actual increased retirement benefit for retired state employees is the fact that the funding of the section 5 adjustment bears no resemblance to the funding of actual state retirement benefit adjustments previously enacted by the legislature. [Such previous enactments were] funded by investment income produced by the retirement fund made up of employee and employer contributions. Here, the funding for the so-called retirement adjustment payment is statutorily appropriated from the general fund * * *.

"We conclude that the adjustment is a partial tax rebate denominated otherwise in an attempt to evade the requirements of federal law." *Id.* at 138-39, 864 P2d at 768 (citation omitted; emphasis in original).

Taxpayer argues that, Oregon Laws 1991, chapter 796, like the Montana enactment examined in *Sheehy*, is a partial tax rebate for state retirees and, therefore, that it constitutes discriminatory taxation of federal retirees who do not receive the same benefits. We disagree.

The *Sheehy* court's conclusion that the Montana adjustment is a partial tax rebate that violated federal law relied heavily on two features of the Montana enactment: (1) that only retirees who are Montana residents will receive the benefit, and (2) that the retirement benefits at issue are funded solely by the Montana *general fund.*

In contrast, under Oregon Laws 1991, chapter 796, every state retiree who qualifies for benefits (based on years of service) will receive the benefits, regardless of the state retiree's residency. Moreover, the challenged provisions of Oregon Laws 1991, chapter 796, do not appropriate money from the Oregon general fund. Rather, the increased PERS retirement benefits are funded by contributions from all PERS employers to the PERS retirement trust fund. Or Laws 1991, ch 796, § 3.[14]

Intergovernmental tax immunity is based on the need to protect each sovereign's governmental operations from undue interference by the other. *Davis,* 489 US at 814. We agree with the Tax Court that "Davis does not hold, or even intimate that a state is prohibited from adjusting the compensation of its employees, either currently or retired, to make up for the loss of the [income tax] exemption." *Ragsdale,* 13 OTR at 146.[15]

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[14] *Compare Hughes,* 314 Or at 27 (relying on earlier Oregon case law, concluding that PERS is a contract between the state and its employees), with *Sheehy v. Public Employees Retirement Div.,* 262 Mont 129, 133-34, 864 P2d 762, 765, *reh den* (1993) (relying on earlier Montana case law, concluding that Montana retirement benefits tax exemption laws do not constitute a contract).

[15] Because we hold that taxpayer has not shown any discrimination in the tax treatment of state and federal retirees, we need not consider the second prong of *Davis,* i.e., whether any inconsistent tax treatment is directly related to, or justified by, significant differences between the two classes. 489 US at 816.

Justice Gillette, dissenting, concludes that the state retirees' increased PERS retirement benefits are, in fact, a partial refund of state income taxes paid by state retirees on their PERS retirement income and would hold:

> "So long as there is a direct tie between state income taxation of PERS retirement benefits and the availability of increased PERS retirement benefits, it is not even necessary to inquire whether there are other, additional grounds on which to declare the present taxation scheme to be impermissibly discriminatory." 321 Or at 234 (Gillette, J., dissenting).

We are not persuaded by that analysis.

A tax rebate or tax benefit program only for state employees clearly would be impermissible. The Oregon law, however, is not a tax rebate program or a tax benefit. Everyone's income is taxed equally. The state is entitled to raise the level of taxable compensation of its employees, *for whatever reason,* including to compensate them for a change in the tax laws that results in a decreased level of net after-tax income.

For example, if the state government changed the state tax laws to limit the deduction for mortgage payments and chose to raise the level of state employees' compensation because of the change, that should not violate the federal law. Everyone is taxed in the same way; the state can pay its employees what it wants to pay them. Nor should it be deemed to violate the federal law if the raise is good only for as long as the tax law change is good, which is Justice Gillette's point of departure. That tie-in defines the duration of the change in taxable compensation, but it has no impact on the comparative equity of the state system of taxation.

Nowhere in the federal doctrine of intergovernmental tax immunity is there the idea that a state's choice to expend more of its money on the compensation of state governmental employees violates the doctrine. That choice by the state may or may not increase the overall tax burden on everyone (state and federal public employees, private wage earners, businesses) depending on budget and taxation choices made by the legislature. Those are policy choices, subject to a watchful electorate that includes a vast majority of people who are not state employees, but they do not raise intergovernmental tax immunity concerns.

The state should be free to compensate its employees with its eyes open to the tax burdens that it places on them. We do not believe that the Supreme Court of the United States would assert that the principle of intergovernmental tax immunity deprives the state of its sovereignty to fix the level of its employees' compensation and to ensure that their net after-tax income is at a level commensurate with the agreement of the employees and the state. Federal employees lose the right to complain about inequality in the state tax system when the system treats them equally. Oregon now does that. Justice Gillette's analysis focuses on one fact, the durational tie-in to the tax laws of the raise in compensation, to the unwarranted exclusion of literally everything else. In context, we do not believe that that tie-in supports taxpayer's claim here.

Justice Fadeley, who concurred in part with this court's holding in *Hughes* that PERS retirement benefits accrued or accruing for work performed on or before September 28, 1991, may not be taxed, would have gone further in *Hughes* to hold that any action to tax PERS retirement benefits under Oregon Laws 1991, chapter 823, section 3, was unconstitutional. *Hughes,* 314 Or at 37-38 (Fadeley, J., concurring in part and dissenting in part). Implicit in his analysis is a con-

clusion that, under *Davis,* the state's only recourse is to exempt state and retirees' retirement benefits from state income taxation. In this case, Justice Fadeley pursues that same analysis to conclude that federal retirement income must be exempt from state income taxation. 321 Or at 235-36 (Fadeley, J., dissenting). His conclusion, however, is based on a faulty premise, *i.e.,* that the state could not tax PERS retirement benefits. As this court held in *Hughes,* the state may tax PERS retirement benefits but, in doing so, the state became liable for damages for breach of contract. Because the state may tax PERS retirement benefits and does so, the state does not discriminate against federal retirees when it taxes federal retirement benefits equally.

We hold that the benefits paid to state retirees, pursuant to Oregon Laws 1991, chapter 796, do not give rise to a violation of 4 USC § 111 and the constitutional principle of intergovernmental tax immunity.

The judgment of the Tax Court is affirmed.

GILLETTE, J., dissenting.

The majority today approves a legislative device specifically and narrowly tailored to avoid the rule of intergovernmental tax immunity that was explicated by the Supreme Court of the United States in *Davis v. Michigan Dept. of Treasury,* 489 US 803, 109 S Ct 1500, 103 LEd 2d 891 (1989) and elaborated in *Harper v. Virginia Dept. of Taxation,* 509 US ___, 113 S Ct 2510, 125 LEd 2d 74 (1993) (applying rule of *Davis* retroactively) and *Barker v. Kansas,* 503 US 594, 112 S Ct 1619, 118 L Ed 2d 243 (doctrine applicable to military retirees' pensions). Because I believe that the legislative scheme does not avoid discriminating between state and federal retirees pensions benefits, based on the source of those benefits, I dissent.

I begin with a proposition that I hope even the majority would accept: Just as Davis forbids total discrimination in taxation between state and federal retirement benefits, based on the source of those benefits, I conclude that Davis likewise forbids any alternatives to complete discrimination that nonetheless treat retirement benefits differently, depending on the source of those benefits. For example, a state may not erect a statutory scheme that requires that both state and federal retirees pay income taxes on their retirement income, but then provides for complete refunds only to state retirees of all taxes paid on their state retirement benefits. And, because a total, dollar-for-dollar refund to the state retirees in this case of any taxes that they have paid on their PERS retirement benefits would be impermissible, so would be some kind of proportional refund, such as 50 cents for each dollar, unless, of course, federal retirees were accorded the same proportional refund on the income taxes that they paid the state on their retirement benefits.

But it is argued here—and the majority buys the argnment—that the legislature's increase in PERS benefits, while motivated by the requirement that state retirees now pay taxes on their state retirement benefits, is nonetheless simply "increased compensation" and, as such, unrelated to any taxes that any federal retiree may be paying. With respect, I disagree. In spite of the difference in label—"refund" vs. "increased compensation"—I can find no difference in substance here. The pertinent focus here is the degree to which that "increased compensation" is tied to—indeed, is completely contingent on—an obligation on the part of state retirees to pay state income taxes on their PERS retirement benefits. When the state says to state retirees, "We will increase your retirement benefits, but only because you now are being taxed on them *and only for as long as you continue to be taxed on them,*" the state is talking about a tax refund.

And, because the state retirees are receiving a refund of taxes paid on their state retirement income to which federal retirees are not, on the same terms, entitled with respect to their federal retirement income, the violation of the doctrine of intergovernmental tax immunity, as explained in *Davis*, is patent. Substance counts; labels do not.

Even a cursory examination of Oregon's present "increased retirement benefits" arrangement shows that what is going on is, in fact, a *partial refund* of state income taxes paid by state retirees on their PERS retirement income. That proposition is demonstrated ineluctably by the fact that the increased PERS retirement benefits are not payable in any year in which PERS retirement benefits are exempt from Oregon personal income taxation. *See* Or Laws 1991, ch 796, § 12 (so providing). So long as there is a direct tie between state income taxation of PERS retirement benefits and the availability of increased PERS retirement benefits, it is not even necessary to inquire whether there are other, additional grounds on which to declare the present taxation scheme to be impermissibly discriminatory.

The, department does not argue, in the alternative, that Oregon's inconsistent tax treatment between state and federal retirees is permissible because it is directly related to, or justified by, significant differences between the two classes, *Davis,* 489 US at 815-16, 109 S Ct at 1508, 103 LEd 2d at 905, and I do not perceive any such differences.

Based on the foregoing analysis, I would hold that Oregon Laws 1991, chapter 796, is a form of refund of state income taxes paid by state retirees on their PERS retirement income. The taxation of federal retirement benefits without such a refund is, therefore, discrimination in the tax treatment of state and federal retirements, based on the source of those benefits. As such, it is a violation of the doctrine of intergov-

ernmental tax immunity and the mandate of *Davis* for "equal treatment." *Davis,* 489 US at 818, 109 S Ct at 1509, 103 L Ed 2d at 907. The majority errs in concluding otherwise.

I respectfully dissent.

Fadeley, J., joins in this dissenting opinion.

FADELEY, J., dissenting.

I join in the dissenting opinion of Gillette, J., and add the following, also in dissent. In my view, by constitutional law, PERS retirement benefits accruing before 1991 are exempt from state personal income taxation. And, under *Davis v. Michigan Dept. of Treasury,* 489 US 803, 109 S Ct 1500, 103 L Ed 2d 891 (1989), federal employees' pre-1991 retirement benefits are similarly exempt. Equality of treatment is required by the doctrine of intergovernmental tax immunity. Therefore, a parallel exemption from state income tax must be accorded to federal retirees for parallel payments of parallel benefits, according to the Supreme Court of the United States.

In *Harper v. Virginia Dept. of Taxation,* 509 US ___, 113 S Ct 2510, 125 L Ed 2d 74 (1993), that Court summarized:

> "The Michigan tax scheme at issue in *Davis* 'exempt[ed] from taxation all retirement benefits paid by the State or its political subdivisions, but levie[d] an income tax on retirement benefits paid by *** the Federal Government.' 489 U.S., at 805, 109 S.Ct., at 1502. We held that the United States had not consented under 4 U.S.C. § 111[1] to this discriminatory imposi-

[1] In *Hughes v. State of Oregon,* 314 Or 1, 838 P2d 1018 (1992), I pointed out that the state must honor its obligation to preserve tax exemption for PERS retirement benefits accrued before 1991. I explained:

tion of a heavier tax burden on federal benefits than on state and local benefits. *Id.*, at 817, 109 S.Ct. at 1508.

> "'[1] 'The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States * * * by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.' 4 U.S.C. § 111."

Relevant portions of the PERS trust fund capital and income cannot be taxed by the state when transferred to a retiree now or later without impairing the obligation of contract, in my view.[1] Thus, the exemption for PERS benefits that accrued before enactment of the 1991 legislation applies by force of the state constitution. And under federal law, equality of tax treatment is required for federal retirees' parallel benefits.

"The promise was embodied in statute. The statute proclaimed: 'The right of a [PERS member] to a pension * * * shall be exempt from * * * all state, county and municipal taxes heretofore or hereafter imposed.' ORS 237.201 (1989). The trust funds out of which the pension will be paid amounted to $12.5 billion in mid-1991. These trust funds are also covered by the promise of tax exemption by the language in ORS 237.201 extending the promise to cover 'the money in the various funds created by ORS 237.271 and 237.281.' " (Fadeley, J., concurring in part and dissenting in part.) 314 Or at 37.

Restrictions on government acts that impair the obligations of contracts have existed as a constitutional guarantee—and a protection of those who contract with government—since the birth of our federal nation.

See also, United States Trust Co. v. New Jersey, 431 US 1, 97 S Ct 1505, 52 LEd 2d 92 (1977) (a seven member decision applying Us Const, Art I, § 10, cl (1) to invalidate state legislation that repealed a "covenant" previously enacted by statute promising that all of certain revenues would be pledged as security for bonds to be sold, the repeal coming after that promise was accepted by purchase of the bonds).

THE STATUTE AT ISSUE

The plaintiff here contends that a separate statute enacted in 1991 is a continuation in disguise of the former tax exemption for PERS participants and, therefore, that separate statute also violates *Davis,* because plaintiff, as a federal retiree, is not granted the same treatment in relation to state taxation. She points to Oregon Laws 1991, chapter 796, as the culprit. That act mandated that added payments be made out of the PERS fund to the beneficiaries of that fund, namely PERS retirees. Section 3 of that 1991 act amended ORS 237.209, a pre-existing statute section describing monthly benefit levels, by adding a new subsection (6) which increased the monthly retirement allowance payable to specified retirees. The increased payment is one percent for those with at least 10 years of service at retirement and ranges upward to four percent for those with over 25 years of service in the PERS system.

Subsection (6) of the 1991 act provides that these increases "shall be funded by employer contributions." That is, they probably will be paid from a current and future increase in employer contributions, although whether the increase comes from past employer contributions held in trust or from current and future increased contributions is not clear in that statute.

TAXPAYER' S ARGUMENTS

Plaintiff claims that the doctrine of intergovernmental tax immunity requires that she receive an exemption from the state income tax equal to the disguised preferential tax treatment that is represented by those added benefit payment amounts. Other subsections of that act, not created or amended in 1991, have, on several occasions since 1980, mandated similar percentage increases. Those increases have had no

relation to the *Davis* decision. However, the state cannot merely rely on its past practice to justify a discriminatory tax-treatment device enacted post-Davis and in response to problems presented by *Davis.*

In support of her argument, plaintiff also points to a decision of the Montana Supreme Court, *Sheehy v. Public Employees Retirement Div.,* 262 Mont 129, 864 P2d 762 (1993). The underlying facts of that case are far afield from this case. That state did not owe its retirees any contractual obligation of tax exemption.

The partial tax rebate, enacted by the 1991 Oregon legislature, expressly conditions the added benefits payable to PERS retirees on the fact that no state tax exemption is available for the regular amount of PERS payments for any year in which the percentage increment is to be added. Or Laws 1991, ch 796, § 12.

The legislation thus siguals that the sliding-scale, percentage increment is not granted out of legislative largess or a kindly concern about inflationary effects and increases in cost of living for those on fixed incomes. The legislature's motivation in 1991—its intent by enacting chapter 796—is the same as that which originally created the tax exempt status for PERS retirement benefits as a term of the public employment contract in Oregon, namely, to save and maximize the use of taxpayer dollars. Originally, the tax exemption for PERS benefits permitted paying a lesser total dollar amount of retirement benefits which in turn required fewer governmental tax dollars to fund. Tax free treatment also saved the cost of churning the same governmental dollars through an additional state agency, or through the same agency a second time. The failure to grant tax free treatment to federal retirement benefits, and *Davis,* ended that economy. The 1991 legislation continues to indicate a preference for the cost-saving exemption

and thus only adds the percentage increment to retirement benefits in years in which the tax exemption is not in force.[2]

But in years where there is no exemption for PERS payments accruing before 1991, the state and local governments are not living up to their statutory contracts and are obligated to repay to PERS retirees the value of the governmental promise which has been unconstitutionally removed from their pre-1991 employment contracts. The significance of conditioning the additional payment on absence of a state tax exemption is compounded by the relevant statements of the executive-branch revenue agency that is the defendant in this case. Defendant's stated posture indicates its assumption or belief that the legislature was increasing retirement payments, in years where PERS payments are not exempt, to partially[3] off-set the added taxes to be paid by PERS retirees.

No such off-set is provided federal retirees. The majority opinion justifies this disparity by pointing out that the obligation of the state and local government contract that promises to exempt pre-1991 PERS benefits from taxes is not an obligation owed to federal retirees. Although that is correct, the national law also requires equal or parallel tax immunity for retired federal employees. That also is a legal obligation of the state and its local governments.

The 1991 legislative repeal of the prior tax exemption, coupled with legislation mandating a government-paid partial offset as to state and local retirees, fails to fulfill the latter legal obligation, especially where a course of action that clear-

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[2] The extra retirement benefit, funded by added governmental dollars is a "tax expenditure" in fiscal parlance, very similar to a direct tax credit or refund granted by law. The effect on the mathematical balance of the state budget, as to state retirees, is the same.

[3] See *Hughes*, 314 Or at 40-41.

ly fulfills that obligation is so readily available.[4] The Supreme Court of the United States, whose jurisdiction includes enforcing the legal obligations owed by the states in the area of intergovernmental tax immunity, has not been impressed by state explanations of why those obligations do not apply in similar settings to federal employees. *Davis v. Michigan Dept. of Treasury; Harper v. Virginia Dept. of Taxation.* I would hold that the state legislation attacked today cannot, in the circumstances of this case, fulfill either obligation. Tax exemption per the original obligation of contract can do so, but not this half-a-loaf to half-the-people approach.

[4] I refer to the option of exempting both state and federal retirement payments accrued before 1991.

APPENDIX 2

IN THE OREGON TAX COURT

Personal Income Tax
No. 3535

JULIA D. RAGSDALE,)
Plaintiff,)
v.)
DEPARTMENT OF REVENUE,)
State of Oregon,)
Defendant.)

OPINION

In this appeal a recipient of federal pensions seeks refunds of state income taxes. The plaintiff claims that Oregon discriminates against federal pensioners and taxes exempt income. Having stipulated the facts, the parties submitted briefs and presented oral arguments.

Plaintiff Is a resident of Oregon and filed state personal income tax returns for 1991. She receives two federal pensions as " pay or compensation for personal service as an officer or employee of the United States." (Plaintiff's Complaint at 2.) Her federal pension income totaled $31,834 in 1991. Plaintiff initially included this income as taxable, but later filed amended returns claiming refunds.

Plaintiff claims that Oregon impermissibly discriminates between state and federal retirees and, therefore, all of her federal pension income should be exempt. In the alternative, plaintiff asserts that if her federal pension income is subject to state income tax, 66.77 percent of the income is exempt. That is the portion attributable to interest earned by the Civil

Service Retirement and Disability Fund (CSRDF) , the payor of plaintiff's pensions, from investments or obligations of the United States.

TAX HISTORY

Some background must be given before plaintiff' s arguments become clear. For many years, Oregon did not tax pension benefits received from the Oregon public Employes' Retirement System (PERS) , but did tax federal pensions. In *Davis V. Michigan Dept. of Treasury,* 489 US 803, 109 S Ct 1500, 103 L Ed 2d 891 (1989), the United States Supreme Court held that this kind of disparate treatment violated the constitutional principle of intergovernmental tax immunity. In doing so, the Court rejected Michigan's argument that its interest in hiring and retaining employees justified the state exemption. The Court stated that the state's interest "no matter how substantial, is simply irrelevant to an inquiry into the nature of the two classes receiving inconsistent treatment." Id. at 816 (citation omitted) . In response to *Davis,* the Oregon legislature amended its statutes, taxing PERS benefits and federal pensions equally. Or Laws 1991, ch 823, § 3.

As partial compensation to its state retirees for the personal income taxes they would incur, the legislature increased the PERS benefits slightly. Or Laws 1991, ch 796. Later, state employees, both current and retired, sued the state for breach of their employment contract. In *Hughes v. State of Oregon,* 314 Or 1, 838 P2d 1018 (1992) , the Oregon Supreme Court held that the state had breached its contract with its employees and must provide a remedy.[1]

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[1] The court declined to fashion any remedy and left it to the legislature. However, the 1993 legislature did not act and new litigation is currently pending.

CLAIM OF DISCRIMINATION

With this background, plaintiff now claims that any reimbursement of state employees, whether as increased pension benefits or contract damages, perpetuates the discrimination condemned by *Davis.* As a result, plaintiff believes that she is entitled to a refund of all taxes paid on her federal pensions.

Plaintiff does not claim any discrimination exists in the tax statutes. Both federal pensions and state pensions are now taxed in like manner under the state income tax statutes. Rather, plaintiff's argument is based on an economic analysis which assumes the state may not do with the left hand what it cannot do with the right. An appropriate response to plaintiff's argument echoes the language of *Davis:* What the state does with regard to compensation of its employees, current or retired, is simply irrelevant to an inquiry as to the tax treatment of state and federal pensions.

In essence, plaintiff argues that the state cannot change the compensation of its employees without forfeiting the right to tax federal pension income. This is the very type of interference that the doctrine of intergovernmental tax immunity was intended to prevent. *Davis* did not mandate that state and federal retirees must receive equal pension benefits. Rather, *Davis* requires that both classes must be treated equally by the state's income tax laws. That the state may relieve its employees of the economic consequences of *Davis* merely demonstrates that the Supreme Court threw its net into a shallow pond. The only economic effect noted by the court in *Davis* was an increase in federal income taxes ""in some circumstances." *Davis* at 816, n 4. Aside from administrative confusion and the initial costs of refunds and adjusting systems, *Davis* need have little economic consequence in Oregon.

In summary, plaintiff has not shown or asserted any discrimination in the tax treatment of state and federal retirees. *Davis* does not hold or even intimate that a state is prohibited from adjusting the compensation of its employees, either currently or retired, to make up for the loss of the exemption.

EXEMPT INCOME CLAIM

Having determined that plaintiff's federal pension income is taxable, the court now turns to plaintiff's alternative argument. Under plaintiff's alternative argument, the issue is whether 68.77 percent of plaintiff's pension income is exempt because that portion is earned by CSRDF from investments and obligations of the United States.

The clear and simple answer is no. Any investment income from federal obligations is paid to CSRDF which owns the obligations. Plaintiff's interest in the trust is as an employee-beneficiary Plaintiff' s own complaint asserts that the pensions are paid as compensation for personal services. Under IRC § 61(a) compensation for personal services is gross income subject to taxation. Plaintiff's pension income is taxable as a distribution from a § 401(a) trust under IRC § 72(e). *Guilzon v. Commissioner* 97 TC 237 (1991) *aff'd,* 985 F2d 819 (1993) . Plaintiff cites *Borg v. Dept. of Rev.,* 308 Or 34, 774 P2d 1099 (1989), as authority for the exempt character of income being passed through to a beneficiary of a trust. However, in *Borg* the court was concerned with investment income of a taxpayer. Here, plaintiff receives compensation for personal services. The character of that income to plaintiff is not affected by its source.

Based on the above, the court finds that defendant's Opinion and Order No. 93-3829 must be sustained. Defendant to recover costs.

Dated this 28th day of July, 1994.

_____

JUDGE

APPENDIX 3

IN THE SUPREME COURT
OF THE STATE OF OREGON

JULIA D. RAGSDALE,)
Appellant,)
v.)
DEPARTMENT OF REVENUE,)
State of Oregon)
Respondent.)

(OTC 3535; SC S41581)

In Banc

On appeal from the Oregon Tax Court. Carl N. Byers, Judge.*

Gary R. DeFrang, Portland, attorney for appellant.

Marilyn J. Harbur, Assistant Attorney General, Salem, attorney for respondent.

VAN HOOMISSEN, J.

The Judgement of the Tax Court is affirmed.

Gillette, J., dissented and filed an opinion, in which Fadeley, J., joined.

Fadeley, J., dissented and filed and opinion.

*13 OTR 143 (1994).

DESIGNATION OF PREVAILING PARTY
AND AWARD OF COSTS

Prevailing party: Respondent.
[ ] No costs allowed [X] Costs allowed, payable by: Appellant

MONEY JUDGMENT

Judgement #1

Creditor: STATE OF OREGON, DEPARTMENT OF REVENUE

Debtor: JULIA D. RAGSDALE

Costs: $160.00

Attorney Fees: -0-

TOTAL: $160.00

Interest: Simple, 9% per annum, from the date of this appellate judgment.

Appellate Judgment SUPREME COURT
Effective Date: July 11, 1995

APPENDIX 4

CHAPTER 796

AN ACT SB 656

Relating to public employee retirement; creating new provisions; amending ORS 1.343, 237.209, 237.230 and 237.233; and declaring an emergency **Be It Enacted by the People of the State of Oregon:**

SECTION 1. Section 2 of this Act is added to and made a part of ORS 237.001 to 237.315.

SECTION 2. (1) Upon retirement of an employee who is a member of the system and computation of that member's service retirement allowance under ORS 237.111, 237.147 or 237.155, or computation of any disability retirement allowance under ORS 237.171, 237.181 or 237.187, the board shall add to the amount of the allowance, including the amount of any refund of accumulated employee contributions, an additional amount equal to the percentage increase provided in subsection (4) of this section.

(2) The amount of any death benefit under ORS 237.165, 237.167 or 237.169, including the amount of any monthly payments, shall be increased by an amount equal to the percentage increase provided in subsection (4) of this section.

(3) A member of the system who receives a lump sum under ORS 237.151 in lieu of a retirement allowance or other benefit shall receive an additional amount equal to the percentage increase provided in subsection (4) of this section.

(4)(a) The percentage increases provided for in this section to the benefits payable to or on account of a member of the system who is serving as other than a police officer or fire fighter at the time of death or retirement shall be:

(A) For a member with 10 or more years of service in the system but less than 20 years, one percent.

(B) For a member with 20 or more years of service in the system but less than 25 years, two percent.

(C) For a member with 25 or more years of service in the system but less than 30 years, three percent.

(D) For a member with 30 or more years of service in the system, four percent.

(b) The percentage increases provided for in this section to the benefits payable to or on account of a member of the system who is serving as a police officer or fire fighter at the time of death or retirement shall be:

(A) For a member with 10 or more years of service in the system but less than 20 years, one percent.

(B) For a member with 20 or more years of service in the system but less than 25 years, two and one-half percent.

(C) For a member with 25 or more years of service in the system, four percent.

(c) The benefits payable to or on account of a member with less than 10 years of service in the system at the time of death or retirement shall not be increased under the provisions of this section.

(5) The increased benefits provided for in this section shall be funded by employer contributions.

(6) This section applies only to members whose effective date of retirement or death is on or after January 1, 1991.

SECTION 3. ORS 237.209 is amended to read:

237.209. (1) In addition to any increase under ORS 237.060, first effective for the month of August 1981, payable September 1, 1981, the monthly retirement allowance payable to or on account of any person who has retired as a member of the Public Employes' Retirement System shall be increased by a percentage based on the calendar year in which the person retired, as set forth in the following table:

Calendar Year of Retirement	Percentage Increase	Calendar Year of Retirement	Percentage Increase
1980	4.00	1964	8.12
1979	4.32	1963	8.32
1978	4.76	1962	8.56
1977	4.44	1961	8.64
1976	4.72	1960	8.76
1975	4.92	1959	8.96
1974	5.28	1958	9.08
1973	5.92	1957	9.28
1972	6.20	1956	9.68
1971	6.36	1955	10.00
1970	6.60	1954	10.04
1969	6.88	1953	10.16
1968	7.20	1952	10.56
1967	7.36	1951	10.64
1966	7.56	1950	11.40
1965	7.88	or any previous year	11.40

(2) In addition to any increase under ORS 237.060 and subsection (1) of this section, first effective for the month of July 1982, payable August 1, 1982, the monthly retirement allowance payable to or on account of any person who has

retired as a member of the Public Employes' Retirement System shall be increased by a percentage based on the calendar year in which the person retired. The percentage shall be four percent in respect to a person who retired in the calendar year 1981. The percentage in respect to a person who retired in a calendar year previous to the calendar year 1981 shall be the applicable percentage in the table set forth in subsection (1) of this section.

(3) In addition to any increase under ORS 237.060, first effective for the month of July 1985, payable August 1, 1985, the monthly retirement allowance payable to or on account of any person who has retired as a member of the Public Employes' Retirement System shall be increased by a percentage based on the calendar year in which the person retired, as set forth in the following table:

Calendar Year of Retirement	Percentage Increase	Calendar Year of Retirement	Percentage Increase
1983	3.00	1967	5.60
1982	3.01	1966	5.73
1981	3.09	1965	5.94
1980	3.24	1964	6.09
1979	3.48	1963	6.22
1978	3.80	1962	6.37
1977	3.57	1961	6.42
1976	3.77	1960	6.50
1975	3.92	1959	6.62
1974	4.17	1958	6.70
1973	4.63	1957	6.82
1972	4.82	1956	7.06
1971	4.93	1955	7.25
1970	5.09	1954	7.28
1969	5.28	or any previous year	7.28
1968	5.49		

(4) In addition to any increase under ORS 237.060 and subsection (3) of this section, first effective for the month of July 1986, payable August 1, 1986, the monthly retirement allowance payable to or on account of any person who has

retired as a member of the Public Employes' Retirement System shall be increased by a percentage based on the calendar year in which the person retired. The percentage shall be three percent in respect to a person who retired in the calendar year 1984. The percentage in respect to a person who retired in a calendar year previous to the calendar year 1984 shall be the applicable percentage in the table set forth in subsection (3) of this section.

(5) In addition to any increase under ORS 237.060, first effective for the month of July 1989, payable August 1, 1989, the monthly retirement allowance payable to or on account of any person who has retired as a member of the Public Employes' Retirement System shall be increased by a percentage based on the calendar year in which the person retired, as set forth in the following table:

Calendar Year of Retirement	Percentage Increase	Calendar Year of Retirement	Percentage Increase
1988	0	1968	7
1987	0	1967	0
1986	0	1966	0
1985	0	1965	0
1984	0	1964	0
1983	0	1963	1
1982	0	1962	1
1981	0	1961	2
1980	3	1960	3
1979	11	1959	3
1978	16	1958	5
1977	3	1957	9
1976	7	1956	9
1975	15	1955	7
1974	25	1954	8
1973	14	1953	8
1972	15	1952	10
1971	0	1951	19
1970	0	1950	18
1969	4	or any previous year	18

(6) In addition to any increase under ORS 237.060, first effective for the month of December 1990, payable January 1, 1991, the monthly retirement allowance payable to or on account of any person who has retired as a member of the Public Employes' Retirement System shall be increased by the following percentages:

(a) If the member was serving as other than a police officer or fire fighter at the time of retirement, the percentage increase shall be:

(A) For a member with 10 or more years of service in the system but less than 20 years, one percent.

(B) For a member with 20 or more years of service in the system but less than 25 years, two percent.

(C) For a member with 25 or more years of service in the system but less than 30 years, three percent.

(D) For a member with 30 or more years of service in the system, four percent.

(b) If the member was serving as a police officer or fire fighter at the time of retirement, the percentage increase shall be:

(A) For a member with 10 or more years of service in the system but less than 20 years, one percent.

(B) For a member with 20 or more years of service in the system but less than 25 years, two and one-half percent.

(C) For a member with 25 or more years of service in the system, four percent.

(c) The monthly retirement allowance payable to or on account of a member with less than 10 years of service in the system at the time of retirement shall not be increased under the provisions of this subsection.

(7) The increased allowance provided in subsection (6) of this section shall be funded by employer contributions.

SECTION 4. ORS 237.230 is amended to read:

237.230. (1) Every monthly retirement allowance or pension payable to a judge member or surviving spouse of a judge member under ORS 237.211 to 237.233 shall be adjusted annually to reflect the percentage increase or decrease in the cost of living as provided in ORS 237.060.

(2) ORS 237.209 (4) *[and (5)]* **to (7)** apply in respect to a judge member who retired in the calendar year 1984 or any calendar year thereafter as provided in ORS 237.209 (4) *[and (5)]* **to (7),** and for that purpose the monthly retirement referred to in ORS 237.209 (4) *[and (5)]* **to (7)** shall be the monthly retirement allowance payable to a judge member or the monthly pension payable to the surviving spouse of a judge member under ORS 237.227 (3)(a).

SECTION 5. ORS 237.233 is amended to read:

237.233. (1) ORS 237.003 (2) and (8), 237.005, 237.091, 237.101, 237.125, 237.139, 237.143, 237.145, 237.153, 237.157, 237.201, 237.205, 237.248, 237.251, 237.253, 237.259, 237.263, 237.271, 237.275, 237.277, 237.279, 237.281, 237.285, 237.291, 237.301, 237.315, [and] 237.320 **and the increases provided by section 2 of this 1991 Act for members of the system who are serving as other than police officers or fire fighters** apply in respect to judge members.

(2)ORS 237.001 to 237.315 applies in respect to persons described in ORS 237.215 (1) and in respect to judge members only as specifically provided in ORS 237.211 to 237.233.

SECTION 6. Section 7 of this Act is added to and made a part of ORS 1.314 to 1.380.

SECTION 7. (1) Upon computation of the retirement pay of a judge under ORS 1.340 or the pension of the surviving spouse of a judge under ORS 1.340, there shall be added to the amount of the retirement pay or pension an additional amount equal to the percentage increase provided in subsection (3) of this section.

(2) The amount of any benefit payable under ORS 1.340 (7) or 1.346 shall be increased by an amount equal to the percentage increase provided in subsection (3) of this section.

(3) The percentage increases under this section shall be:

(a) For the retirement pay or pension payable to or on account of a judge with 10 or more years of service as a judge but less than 20 years, one percent.

(b) For the retirement pay or pension payable to or on account of a judge with 20 or more years of service as a judge but less than 25 years, two percent.

(c) For the retirement pay or pension payable to or on account of a judge with 25 or more years of service as a judge but less than 30 years, three percent.

(d) For the retirement pay or pension payable to or on account of a judge with 30 or more years of service as a judge, four percent.

(4) The retirement pay or pension payable to or on account

of a judge with less than 10 years of service as a judge at the time of retirement shall not be increased under the provisions of this section.

(5) The increase in retirement pay and pensions provided in subsection (1) of this section applies only to judges whose effective date of retirement is on or after January 1, 1991, and to the surviving spouses of judges who die on or after January 1, 1991.

(6) The increase in benefits provided in subsection (2) of this section applies only to benefits that become payable on or after January 1, 1991.

SECTION 8. ORS 1.343 is amended to read:

1.343. (1) A person entitled to receive retirement pay or a pension under ORS 1.314 to 1.380 on August 1, 1979, shall receive on and after August 1, 1979, out of the Judges' Retirement Fund, an additional monthly amount as retirement pay or pension determined by applying to the retirement pay or pension paid to the person for the month of July 1979 the percentage increases before July 1, 1979, provided for in ORS 237.060 and 237.199 that would have been applicable if the person had retired and been receiving a retirement allowance under ORS 237.001 to 237.315:

(a) If the person is a retired judge, at the time the person retired under ORS 1.314 to 1.380; or

(b) If the person is the surviving spouse of a judge or former judge, at the time the judge or former judge retired under ORS 1.314 to 1.380 or died, whichever occurred first.

(2) A person entitled to receive retirement pay or a pension under ORS 1.314 to 1.380 on August 1, 1983, shall receive, on

and after August 1, 1983, out of the Judges' Retirement Fund, an additional monthly amount as retirement pay or pension determined by applying to the retirement pay or pension paid to the person for the month of July 1983 the percentage increases on and after July 1, 1979, and before July 1, 1983, provided for in ORS 237.060 that would have been applicable if the person had retired and been receiving a retirement allowance under ORS 237.001 to 237.315:

(a) If the person is a retired judge, at the time the person retired under ORS 1.314 to 1.380; or

(b) If the person is the surviving spouse of a judge or former judge, at the time the judge or former judge retired under ORS 1.314 to 1.380 or died, whichever occurred first.

(3) A person entitled to receive retirement pay or a pension under ORS 1.314 to 1.380 shall receive, out of the Judges' Retirement Fund, an additional monthly amount as retirement pay or pension determined as provided in ORS 237.060. This subsection is first applicable for the purpose of determining additional monthly amounts for the month of July 1984, payable August 1, 1984.

(4) A person entitled to receive retirement pay or a pension under ORS 1.314 to 1.380 for the month of July 1989 shall receive, for the month of July 1989 and each month thereafter, out of the Judges' Retirement Fund, an additional monthly amount as retirement pay or pension determined by applying to the retirement pay or pension otherwise payable to the person for the month of July 1989 a percentage based, if the person is a retired judge, on the calendar year in which the person retired under ORS 1.314 to 1.380, or if the person is the surviving spouse of a judge or former judge, on the calen-

dar year in which the judge or former judge retired under ORS 1.314 to 1.380 or died, whichever occurred first, as set forth in the following table:

Calendar Year of Retirement	Percentage Increase	Calendar Year of Retirement	Percentage Increase
1988	0	1968	48
1987	0	1967	39
1986	0	1966	43
1985	0	1965	47
1984	0	1964	50
1983	0	1963	53
1982	0	1962	54
1981	7	1961	55
1980	18	1960	58
1979	29	1959	59
1978	37	1958	64
1977	8	1957	70
1976	13	1956	72
1975	22	1955	71
1974	34	1954	72
1973	34	1953	73
1972	35	1952	77
1971	30	1951	91
1970	36	1950 or earlier	93
1969	43		

(5) In addition to any other increase payable under this section, a person entitled to receive retirement pay or a pension under ORS 1.314 to 1.380 in the month of December 1990 shall receive for the month of December 1990, payable January 1, 1991, and each month thereafter, out of the Judges' Retirement Fund, an increase in monthly retirement pay or pension equal to the following percentages:

(a) For the retirement pay or pension payable to or on account of a judge with 10 or more years of service as a

judge but less than 20 years, one percent.

(b) For the retirement pay or pension payable to or on account of a judge with 20 or more years of service as a judge but less than 25 years, two percent.

(c) For the retirement pay or pension payable to or on account of a judge with 25 or more years of service as a judge but less than 30 years, three percent.

(d) For the retirement pay or pension payable to or on account of a judge with 30 or more years of service as a judge, four percent.

(6) The retirement pay or pension payable to or on account of a judge with less than 10 years of service as a judge at the time of retirement shall not be increased under the provisions of subsection (5) this section.

SECTION 9. (1) The amendments to ORS 237.209 and 237.230 by sections 3 and 4 of this Act apply only to the retirement allowances of members whose effective date of retirement is before January 1, 1991.

(2) The amendments to ORS 1.343 by section 8 of this Act apply only to the retirement pay of judges whose effective date of retirement is before January 1, 1991, and to the pensions of surviving spouses of judges who die on or before January 1, 1991.

SECTION 10. Section 11 of this Act is added to and made a part of ORS chapter 237.

SECTION 11. Any public employer that provides retirement benefits to its police officers and fire fighters other than by participation in the Public Employes' Retirement System pursuant to the provisions of ORS 237.620 (4) shall provide

increases to the police officers and fire fighters of the public employer, both active and retired, that are equal to the increases in retirement benefits that are provided for in this 1991 Act for active and retired police officers or fire fighters who are members of the Public Employes' Retirement System, or shall provide to those police officers and fire fighters increases in retirement benefits that are the actuarial equivalent of the increases in retirement benefits that are provided for in this 1991 Act for police officers or fire fighters who are members of the Public Employes' Retirement System. No other retirement benefit or other benefit provided by those public employers shall be decreased by the employer by reason of the increases mandated by this section.

SECTION 12. (1) Notwithstanding any other provision of this Act, the increased benefits payable under ORS 237.209, 237.230 and 237.233, as amended by sections 3, 4 and 5 of this Act, and sections 2 and 14 of this Act shall not be paid in any tax year in which the retirement benefits payable under the Public Employes' Retirement System are exempt from Oregon personal income taxation. In the event increased benefits under this Act are paid in a tax year in which the retirement benefits payable under the system are exempt from Oregon personal income taxation, the benefits shall not be recoverable by the system, but the Public Employes' Retirement Board shall insure that no additional amounts are paid under the provisions of this Act.

(2) Notwithstanding any other provision of this Act, the increased benefits payable under ORS 1.343, as amended by section 8 of this Act, and section 7 of this Act shall not be paid in any tax year in which the retirement benefits payable out of the Judges' Retirement Fund are exempt from Oregon personal income taxation. In the event increased benefits under this Act are paid in a tax year in which the retirement benefits

payable out of the fund are exempt from Oregon personal income taxation, the benefits shall not be recoverable by the fund, but the Public Employes' Retirement Board shall insure that no additional amounts are paid under the provisions of this Act.

(3) Notwithstanding any other provision of this Act, the increased benefits payable under section 11 of this Act shall not be paid in any tax year in which the retirement benefits payable by public employers that provide retirement benefits to its police officers and fire pursuant to the provisions of ORS 237.620 (4) are exempt from Oregon personal income taxation. In the event increased benefits under this Act are paid in a tax year in which the retirement benefits payable out of the fund are exempt from Oregon personal income taxation, the benefits shall not be recoverable, but the public employer shall insure that no additional amounts are paid under the provisions of this Act.

SECTION 13. (1) On or before December 1, 1991, the Public Employes' Retirement Board shall determine the amount of any additional payments due as the result of this Act and shall mail checks in payment of those amounts.

(2) On or before December 1, 1991, any public employer that provides retirement benefits to its police officers and fire fighters other than by participation in the Public Employes' Retirement System pursuant to the provisions of ORS 237.620 (4) shall determine the amount of any additional payments due as the result of this Act and shall mail checks in payment of those amounts.

SECTION 14. (1) Any member of the Public Employes' Retirement System whose effective date of retirement was before January 1, 1991, and who elected to receive a refund of accumulated member contributions on an installment basis

under the provisions of ORS 237.155 (3), shall receive an increased benefit at the time each installment is paid equal to the percentage increase provided in section 2 (4) of this Act.

(2) This section applies only to installments paid under ORS 237.155 (3) on or after January 1, 1991.

SECTION 15. (1) Jurisdiction to determine whether the taxation of retirement benefits received by retired members of the Public Employes' Retirement System and other retirement systems established by this state or political subdivisions of this state is in violation of any constitutional provision, including but not limited to violation of contract rights of retired members under section 21, Article I of the Oregon Constitution, or clause 1, section 10, Article I, Constitution of the United States, is conferred upon the Supreme Court. If the Supreme Court determines that such taxation violates constitutional provisions, the Supreme Court may, in its discretion, fashion an appropriate remedy.

(2) Under the jurisdiction conferred in subsection (1) of this section, any person interested in or affected or aggrieved by a state income tax imposed upon amounts received from the Public Employes' Retirement System and other retirement systems established by this state or Political subdivisions of this state may petition the Supreme Court for review. The petition shall state the facts showing how the petitioner is interested, affected or aggrieved, and the constitutional grounds upon which the petition is based. The Supreme Court shall give priority on its docket to a petition for review filed under this subsection, and shall expedite a decision on the petition. Any and all petitions filed under this section alleging a similar basis or bases of challenge may be consolidated by the Supreme Court upon its own motion.

(3) For the purposes of subsection (2) of this section, a person shall be considered interested in or affected or aggrieved without further proof if the person is a retired member of the Public Employes' Retirement System or of a retirement system established by this state or political subdivisions of this state who is receiving a retirement benefit that is subjected to Oregon income taxation under any act of the Sixty-sixth Legislative Assembly.

(4) No person petitioning for review under this section shall be required to exhaust administrative remedies or file in any other court prior to filing a petition for review under this section.

(5) Except as provided in section 12 of this Act, a determination by the Supreme Court that the taxation of retirement benefits received by retired members of the Public Employes' Retirement System and other retirement systems established by this state or political subdivisions of this state is in violation of constitutional provisions shall not affect the right of any person to receive the increased benefits provided by this Act.

(6) A petition for review under this section may only be filed within 60 days after the effective date of any Act of the Sixty-sixth Legislative Assembly subjecting retirement benefits received by retired members of the Public Employes' Retirement System and other retirement systems established by this state or political subdivisions of this state to state income taxation.

SECTION 16. This Act being necessary for the immediate preservation of the public peace, health and safety, an emergency is declared to exist, and this Act takes effect on its passage.

Approved by the Governor August 5, 1991
Filed in the office of Secretary of State August 5, 1991

APPENDIX 5

CHAPTER 823

AN ACT HB 2352

Relating to finance; creating new provisions; and amending ORS 237.201, 310.635, 316.087, 316.680 and 316.695.

Be It Enacted by the People of the State of Oregon:

SECTION 1. ORS 237.201 is amended to read:

237.201. (1) The right of a person to a pension, an annuity or a retirement allowance, to the return of contribution, the pension, annuity or retirement allowance itself, any optional benefit or death benefit, or any other right accrued or accruing to any person under the provisions of ORS 237.001 to 237.315, and the money in the various funds created by ORS 237.271 and 237.281, shall be exempt from garnishment and all state, county and municipal taxes heretofore or hereafter imposed, except as provided under ORS chapter 118, shall not be subject to execution, garnishment, attachment or any other process or to the operation of any bankruptcy or insolvency law heretofore or hereafter existing or enacted except for execution or other process upon a support obligation or an order or notice entered pursuant to ORS 25.050, 25.060, 25.310, 25.350, 25.360, 25.450, 416.445 or 419.515, and shall be unassignable.

(2) Subsection (1) of this section does not apply to state personal income taxation of amounts paid wider ORS 237.001 to 237.315.

* * *

SECTION 5. (1) In the case of a resident eligible individual, there shall be allowed as a credit against the taxes otherwise due under this chapter for the taxable year an amount equal to the lesser of the tax liability of the taxpayer or nine percent of net pension income.

(2) For purposes of this section:

(a) "Eligible individual" means any individual who is receiving pension income and who has attained the following age before the close of the taxable year:

(A) For taxable years beginning on or after January 1, 1991, and before January 1, 1993, the individual must attain 58 years of age before the close of the taxable year.

(B) For taxable years beginning on or after January 1, 1993, and before January 1, 1995, the individual must attain 59 years of age before the close of the taxable year.

(C) For taxable years beginning on or after January 1, 1995. and before January 1, 1997, the individual must attain 60 years of age before the close of the taxable year.

(D) For taxable years beginning on or after January 1, 1997, and before January 1, 1999, the individual must attain 61 years of age before the close of the taxable year.

(E) For taxable years beginning on or after January 1, 1999, the individual must attain 62 years of age before the close of the taxable year.

(b) "Household income" has that meaning, given in ORS 310.630 except that "household income" shall not include social security benefits received by the taxpayer or the spouse of the taxpayer.

(c) "Net pension income" means:

(A) For eligible individuals filing a joint return, the lesser of the pension income of the eligible individuals received during the taxable year or the excess. if any of $15,000 over the sum of the following amounts:

(i) Any social security benefits received by the eligible individual, or by the spouse of the individual, during the taxable year; and

(ii) The excess, if any, of household income over $30,000.

(B) For an eligible individual filing a return other than a joint return, the lesser of the pension income of the eligible individual received during the taxable year or the excess, if any, of $7,500 over the sum of the following amounts:

(i) Any social security benefits received by the eligible individual during the taxable year; and

(ii) The excess, if any, of household income over $15,000.

(d) "Pension income" means income included in federal taxable income from:

(A) Distributions from or pursuant to an employee pension benefit plan, as defined in section 3(2) of the Employe Retirement Income Security Act of 1974, which satisfies the requirements of section 401 of the Internal Revenue Code;

(B) Distributions from or pursuant to a public retirement system of this state or a political subdivision of this state, or a public retirement system created by an Act of this state or a political subdivision of this state, or the public retirement system of any other state or local government;

(C) Distributions from or pursuant to a federal retirement system created by the Federal Government for any officer or employee of the United States, including any person retired from service in the United States Civil Service, the Armed Forces of the United States or any agency or subdivision thereof;

(D) Distributions or withdrawals from or pursuant to an eligible deferred compensation plan which satisfies the requirements of section 457 of the Internal Revenue Code;

(E) Distributions or withdrawals from or pursuant to an individual retirement account, annuity or trust or simplified employee pension which satisfies the requirements of section 408 of the Internal Revenue Code; and

(F) Distributions or withdrawals from or pursuant to an employee annuity, including custodial accounts treated as annuities, subject to section 403 (a) or (b) of the Internal Revenue Code.

(e) "Social security benefits" means social security benefits, as defined in section 86 of the Internal Revenue Code (Title II social security or tier 1 railroad retirement benefits).

(3) A nonresident eligible individual shall be allowed the credit computed in the same manner and subject to the same limitations as the credit allowed a resident by subsection (1) of this section. However the credit shall be allowed only in that proportion that the eligible individual's pension income included in federal adjusted gross income from Oregon sources bears to the eligible individual's pension income included in federal adjusted gross income from all sources.

(4) If a change in the taxable year of the eligible individual occurs as described in ORS 314.085, or if the department

terminates the tax year of the eligible individual under ORS 314.440, the credit allowed by this section shall be prorated or computed in a manner consistent with ORS 316.085.

(5) If a change in the status of the eligible individual from resident to nonresident or from nonresident to resident occurs, the credit allowed by this section shall be determined in a manner consistent with subsection (3) of this section.

(6) For purposes of this section, "federal adjusted gross income" is as described in ORS 316.013.

CERTIFICATE OF SERVICE

Pursuant to Rule 29 of the Rules of the Supreme Court of the United States, this certifies that three copies of the foregoing petition for writ of certiorari were served on:

Mr. Theodore R. Kulongoski
Attorney General for the State of Oregon
Department of Justice
Salem, Oregon 97310,

and that one additional copy of the petition was served on:

Ms. Marilyn J. Harbur
Assistant Attorney General for the State of Oregon
Department of Justice
Salem, Oregon 97310.

All parties required to be served have been served. All service was done by mail with postage prepaid on October 10, 1995.

OCT 10 1995
Date

/S/ JOSEPH WETZEL
Joseph Wetzel
Counsel for petitioner